

# Is the ‘Brazil Brand’ in crisis?

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»» For the past ten years, the world has celebrated Brazil’s success. Its economy spiked, growing at up to 7 per cent annually, helping to lift over 40 million Brazilians out of poverty and into the new middle class. The country now seems to have entered into a second phase of development: economic growth has decelerated and the new middle class has begun to claim their rights. Ahead of the World Cup in summer and the presidential elections in October 2014, the wave of protests that broke out in June 2013 presents new challenges for the government. President Dilma Rousseff will have to meet some of the protesters’ demands so as not to risk a potential second term and Brazil’s global ascent, largely based on the expansion of the domestic market due to inclusion policies, as well as the integration of much of the informal economy into the formal system. Two parallel strategies are needed to overcome the current stagnation: to continue improving domestic development and to deepen international engagement through new trade strategies.

## PROTESTS AND DOMESTIC DEFICITS

Following an intense focus on international relations during Lula da Silva’s presidencies, Brazil now faces the other side of the coin of its successful global ascent: grievances from an emerging middle class, who

## HIGHLIGHTS

- Brazil seems to have entered into a new phase of development: economic growth has decelerated and the growing middle class has begun to claim their rights.
- Overcoming the current difficulties requires adopting far-reaching reforms at home and deepening international engagement.
- Brazil’s brand rests on socio-economic progress, democratic politics and multilateral engagement. Renewing it requires a state that is both more effective and more open to trade and investment.

»»»»» pays a great deal for a state that provides them relatively little. For example, despite having a universal public education system, children have to attend school in two or three shifts per day, and nearly two-fifths of Brazilians do not have access to primary medical care at the local level. Furthermore, most roads are in poor condition and very few have been built, even though the number of vehicles has more than doubled in the past decade. The same holds for air traffic, yet the airports have barely improved.

The rise in the price of public transportation and the costs associated with the World Cup – the construction of the 12 necessary stadiums will cost 43 per cent more than the original budget – have led to an unexpected wave of protests in the country's main cities. Most complaints relate to the high cost of living, the poor quality of public services, and political corruption. Is this a growth crisis or a more structural challenge? Perhaps a combination of the two. Successful economic and social policies have driven Brazil's spectacular growth. These policies have contributed to a better distribution of wealth and an increase of a middle class with access to credit and the consumption of goods and services. For this reason, the June 2013 protests in a country without a history of political mobilisation has caught observers at both the national and international level by surprise.

It is important to note that social networks were used to convene these protests, in a similar fashion to the Arab spring or the European '*indignados*', reflecting a new culture of openness, flexibility, and cooperation. There are no political leaders driving the protests. What is being questioned is the government's rigidity, its limited interaction with the people, and slow responses by the public authorities.

Brazil's demographic profile also plays an important role in the protests. It is a relatively young country, with a median age of 29 years (according to 2010 data), compared to 34.5 years in China, 37 years in the United States; and 41 years in the EU. The youth expects to

improve their social condition through education and want access to good quality public services, especially taking into account that tax revenues account for 33 per cent of GDP – a level similar to that of Organisation for Economic Cooperation and Development (OECD) countries.

The relationship between the political class and corporations that benefit from subsidies, tax exemptions and concessions of public works has also been questioned. In addition, corruption continues to affect the political class, having already led to the resignation of seven ministers during this administration. Another obstacle for democracy and its institutions is the Brazilian political system, which lacks organic political parties, has limited accountability and is trapped by large economic interests, in addition to an inefficient public administration.

The protesters have achieved the withdrawal of a proposed constitutional amendment that would have limited the investigative powers of the Public Ministry. Moreover, a law increasing the penalty for corruption was passed and the green light was given to a bill to allocate 75 per cent of oil royalties to education and public health. Similarly, the programme 'More Doctors for Brazil' allows foreigners to be hired to cover public health positions in less developed areas. The president had also led an initiative to hold a referendum on political reforms that would change the functioning of political parties and the electoral system. However, the government backed down given limited parliamentary support and it is highly unlikely that political reform will be included in the agenda prior to the October 2014 elections.

As a backdrop, the electoral debate will almost certainly be dominated by a competition among centre-left representatives. According to recent polls, Dilma Rousseff is the leading candidate, although the recently-formed coalition between the Socialist Party of Eduardo Campos (Governor of Pernambuco) and Marina Silva (Lula's environment minister who won 20 million votes

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in the last election) could shake up the country's political chessboard.

### PENDING STRUCTURAL REFORMS

Brazil's growth crisis is associated with several structural limitations. Brazil's development model over recent years has combined a free market economy with greater state intervention to promote economic growth and simultaneously reduce poverty and inequality. The concession of credits to companies, increases in the minimum salary (which almost doubled), subsidies for disadvantaged sectors and the growth of the formal sector – which in 2012 represented 72.8 percent of total employment – have led to

greater purchasing power and consumption.

Between 2004 and 2010, the country registered an average GDP annual growth rate of over 4 per cent. However, the Brazilian economy has become less

competitive due to higher salaries, the appreciation of the real and the lack of structural reform. In 2012, GDP increased by 0.9 per cent and forecasts for 2013 fell to about 2 per cent, two points below initial expectations. Brazil's Central Bank data reported by the *Financial Times* reveal that the Brazilian economy actually contracted in the third and fourth quarters of 2013.

Compared to the social expenditure that reached 15.4 per cent of GDP in 2010, spending on infrastructure is skimpy, representing little more than 2.2 per cent of GDP in 2012 versus the global average of 3.8 per cent. Although the government plans large infrastructure projects, which are included in the 2007 Growth Acceleration Programme (PAC in Portuguese), excessive bureaucracy often slows progress.

Now the government must carry out the reforms that were not undertaken during the times of greater bonanza. The solution is not to increase public spending, which in 2010 already represented more than 40 per cent of GDP, but to reform the costly public pension system (at the age of 54, employees can receive a pension for 70 per cent of their salary, which will pose a problem in the medium term given Brazil's demographic profile), reduce bureaucracy, update labour laws, and improve infrastructure and education. At the same time, Rousseff should promote international trade, which to date has carried little weight in the Brazilian economy thus decelerating economic growth.

### THE NEED FOR GREATER INTERNATIONAL ENGAGEMENT

The 2014 World Cup and 2016 Olympic Games have opened a debate about the distribution of resources between foreign and domestic policy. In light of the protests and upcoming elections, the last months of President Rousseff's term will focus on domestic issues. The decreasing importance of foreign policy is evidenced, amongst others, by the replacement as foreign affairs minister of Antonio Patriota by Luiz Figueiredo Machado, former Ambassador to the UN and head of environment policy at the Brazilian Ministry of Foreign Affairs. The new minister stands out for his good relationship with the president and a low profile.

Former Minister Patriota had established a permanent dialogue with civil society on foreign policy issues, and Minister Figueiredo has promised to work 'more closely with parliament and the citizens'. It is clear that the protests have given way to a new period in foreign policy, which is more closely linked to internal debates and less entrepreneurial at the global level, putting an end to the administration's tendency to isolate foreign relations from the rest of its policies. An example of this is parliament's request for an explanation from the government regarding the massive espionage by the United States on Brazilian government officials.

## The protests in Brazil have shown that foreign and domestic policy feed into each other

»»»»» The major advances that took place during Lula's presidency go to show that the country's international hyperactivity was not in vain. Achievements under Lula include Brazil's membership of the BRICS (together with Russia, India, China and South Africa) and IBSA (with India and South Africa), its presence in the G20 and its leadership in South America (through Mercosur and Unasur). An implicit recognition of Brazil's global role can be found in Brazil's triumph over Mexico in the race to lead the World Trade Organisation (WTO), which Roberto Azevêdo has been heading since September 2013. The hosting of two important international events, such as the World Cup and the Olympic Games, also owes in part to the previous government's efforts.

Despite Brazil's increasing international influence and regional leadership, the question remains of whether it is prepared to face future challenges. Trade is ever more important in the international agenda. Brazil is barely involved in the world's large financial and commercial flows. This strongly contrasts with its global position as an economic power: according to the International Monetary Fund (IMF) and the World Bank, respectively, it is the seventh-largest economy worldwide and the fifth in terms of industrial production. Unlike Germany or Mexico, for example, where trade represents 52 and 33 per cent of GDP, respectively, Brazil's trade only accounts for 13 per cent of the economy and the country's share of global imports and exports is below 2 per cent. With its WTO candidacy, Brazil reaffirmed its commitment to multilateralism and vocation for a more just international system based on a better balance between North and South. However, the focus of free trade negotiations has shifted from global talks to large free trade initiatives in the Atlantic (the Transatlantic Trade and Investment Partnership – TTIP – between the EU and the US) and Pacific (the Trans-Pacific Partnership – TPP – involving the US and 11 other countries in the Asia-Pacific region).

Brazil increasingly trades with China, at the expense of traditional partners like the United

States and European Union (EU). In 2012, China represented 15 per cent of Brazilian trade, closely behind the then EU27 (19.2 per cent) and before the US (11.9 per cent), which accounted for well over 20 per cent of Brazil's trade 10 years ago. Russia, India, China and South Africa together represent nearly the same percentage of Brazilian exports as the EU.

Due to its relative isolation from global trade dynamics and its participation in South-South cooperation, Brazil's development model differs from that of the countries of the Pacific Alliance – Colombia, Chile, Mexico and Peru. These four countries have signed free trade agreements with the EU and the US and could thus develop closer ties with the envisaged transatlantic bloc. Also, once Colombia joins the Asia-Pacific Economic Cooperation (APEC), they could also participate in a possible future free trade zone in the Pacific (TTP).

Brazil, on the other hand, has opted for Mercosur and the BRICS. It seems like a risky bet. For Brazil, Mercosur has become a straitjacket that could condemn it to remain aloof to the new push towards trade liberalisation outside of the WTO. Part of the Brazilian opposition thinks that belonging to an unstable Mercosur, which includes politically unpredictable countries like Argentina and Venezuela, constitutes an obstacle for greater international engagement. Moreover, Brazil's regional leadership is being questioned by the Pacific Alliance, causing a new division between 'free traders' (Pacific Alliance) and 'protectionists' (Mercosur). Finally, the BRICS as a whole do not represent a collective trade option, but rather a platform to claim the reform of the international system.

This begs the question of whether Brazil can become a global power without being part of the new trade dynamics. An important step in this direction would be resuming negotiations with its main socio-economic partner, the EU. After several delays, Mercosur and the EU will exchange commercial offers in February or March 2014 (after postponing the date three times). The

prospects are not encouraging, especially when not even Mercosur's membership is clear. Paraguay has still not fully returned to Mercosur, and Bolivia and Ecuador, which are reluctant to sign free trade agreements, are due to join in the short term. Given these question marks, as well as the EU's focus on the Transatlantic Trade and Investment Partnership and the disconnect between the priorities of the EU and Brazil (the export of services and industrial goods for the EU and of agricultural goods for Mercosur), little is expected from this new round of negotiations between Mercosur and the EU.

### CONCLUSION: WHAT ARE THE PROSPECTS FOR THE 'BRAZIL BRAND'?

Whether Brazil will become a 'frozen' emerging power or a country with stronger domestic development and global presence depends on greater international engagement and domestic reform.

Brazil has showed the world that it is possible to acquire global influence and be among the 10 most important nations of the planet without using the traditional tools of power politics and coercion. Apart from its privileged endowment with natural resources, the ascent of Brazil is based on social changes and the expansion of the domestic market as a driving force for growth, its diplomacy, and its negotiating skills. In this sense, Brazil's trajectory sends an important message to other emerging countries.

First of all, Brazil's brand has been its successful domestic development model. Through South-South cooperation and the creation of alternative alliances like the BRICS, Brazil is exporting its formula to other countries. In this sense, the country's internal growth model also determines its international outlook as a donor.

Second, Brazil is a multi-cultural democratic power. Therefore, whether or not the protesters' demands are met will send the world an important message. Can social protest lead to real

domestic change? If that is the case, Brazil could be an example of how to respond better to popular demands to strengthen both the legitimacy and the effectiveness of the political and economic system.

Third, Brazil is a negotiating power with a strong multilateral commitment to the UN-system. A clear example of this is its position in climate change negotiations, where the country stands between the BRICS and the EU. Another example is its commitment to a successful conclusion of the WTO Doha round and the use of the organisation's dispute settlement mechanisms. In the medium run, through the WTO, Brazil could also seek to act as a bridge between the TTIP and TPP negotiations and, if they are successful, attempt to connect them under the umbrella of the organisation. The so-called Bali-package, approved in December 2013 and which includes a trade facilitation agreement, has breathed new life into the WTO.

The protests in Brazil have shown that foreign and domestic policy feed into each other. The 2014 presidential elections offer the possibility to correct many of the country's current domestic deficits and undertake the needed structural reforms that did not take place during Lula's global hyperactivity. Belonging to the club of global powers means opening up to both the internal demands for more effective governance and the external demands for a government that is less interventionist and more open to trade and investment.

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